1. **Select five financial ratios of your choice and calculate them for the last three years.**

Here are the financial ratios for Howdens Joinery PLC for the last three years, based on their financial statements:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Ratios** | **Formula** | **2023** | **2022** | **2021** |
| 1. **Profitability Ratios** |  |  |  |  |
| Gross Profit Ratio | (Gross Profit / Revenue) × 100 |  |  |  |
| 1. **Efficiency Ratios** |  |  |  |  |
| Asset Turnover Ratio | Revenue / Total Assets |  |  |  |
| Inventory Turnover Ratio | Cost of goods sold **(**COGS) / Average Inventory | =2.41 | =2.71 | =2.67 |
| 1. **Liquidity Ratios** |  |  |  |  |
| Current Ratio | Current Assets / Current Liabilities |  |  |  |
| 1. **Gearing Ratios** |  |  |  |  |
| Debt to Equity Ratio | Total Debt / Total Equity |  |  |  |
| 1. **Investment Ratios** |  |  |  |  |
| Earnings Per Share (EPS) | Earnings / Number of Shares | £0.38 (38 pence) | £0.38 (38 pence) | £0.35 (35 pence) |
| Price/Earnings (P/E) Ratio | Market Value per Share / EPS |  |  |  |

The values expressed by these ratios suggest that Howdens Joinery has established sustainable past three years’ profitability, effective asset management, and adequate cash and cash equivalent position. These ratios suggest that over the past three years, Howdens Joinery has maintained good profitability, effective utilization of assets and good liquidity. However, the figures show that through undertaking of the aforesaid analysis, that the debt to equity has risen supporting a further area for improvement on financial leverage while the inventory turnover ratio has declined supporting the need to improve on inventory management. (Ltd, 2024) (A Nikkei Company, 2024) (howdens, 2024)

1. **Discuss six limitations of ratio analysis.**

**Limitations of Ratio Analysis**

1. **Historical Data Limitations:**

Financial ratios are based on past data whereas such ratios major drawback is that the past data does not necessarily always give an accurate picture of the future. For example, Profitability ratios and figure such as Net Profit Margin or Return on Equity (ROE) capture the organization past earning and cost structure but fail to capture the future changes such as new market entrants or economic shocks that may affect Howdens Joinery PLC profitability (team, 2024).

1. **Lack of Standardization in Accounting Practices**:

Different corporations may use different accounting systems, affecting the comparability of ratios across enterprises. For example, Howdens Joinery may adopt a different method of inventory value or depreciation than its rivals. This might result in variances in profitability statistics such as Gross Margin or Return on Assets, making it difficult to fairly compare Howdens' performance to others in the industry (toppors from bujjus, 2023).

1. **Exclusion of Non-Financial Factors**:

The use of ratio analysis more frequently relies on accounting numbers and sometimes omits other important aspects of a business, which are qualitative. It is worth noting that elements such as the company’s brand recognition, the customers’ loyalty, or the quality of the supply chain suppliers of Howdens Joinery are not captured in number ratios. These elements may affect the company’s position in a specific market and its sustainability over time, which ratios reflect insufficiently.

1. **Inflation and Economic Variability**:

Ratios are not adjusted for inflation, which can misrepresent the underlying economic worth of assets, revenues, and expenses. For Howdens Joinery, variable inflation rates might have an impact on the comparability of financial measures over time (team, 2024). Furthermore, changes in economic conditions, such as interest rate variations or consumer spending, can have an influence on ratios such as the Current Ratio or Debt-to-Equity Ratio, suggesting non-operational changes in liquidity or financial stability.

1. **Limited Scope of Analysis**:

Problems with the financial ratios, financial ratios give different pictures of some areas of a company’s financial health, though they never offer a full picture. For instance, some of the profitability ratios can show that Howdens is controlling or has improved, or otherwise negatively impacted on its costs but do not look at the reasons behind fluctuating costs. In the same way, the ratios of liquidity indicate a problem with cash flow but do not reveal the causes of such a problem, for example, attractive investment opportunities or changes in the credit policy with suppliers.

1. **Susceptibility to Manipulation**:

That companies might for instance overwrite some figures or use other accounting tricks to make their financial statements look better. Indeed, Howdens Joinery was capable of influencing and managing its earning through adjustments of polices for revenue recognition and company’s expenses, and through the management of its assets. These manipulations can skew financial ratios and give stakeholders inaccurate perceptions of the company’s financial health which is why it is necessary to glance at the accounting policies (WSO, 2023).

1. **Comment critically on the financial position (strengths and/or weaknesses) of your company and how it has changed over the last three-year period. Your comments should include an analysis of the reasons behind deterioration/improvement in performance.**

**Analysis of Howdens Joinery PLC's Financial Position**

To evaluate Howdens Joinery PLC's financial status over the previous three years, we will look at important measures such as sales, gross profit, operational profit, and profit before tax.

1. **Revenue and Gross Profit:**

* **2021**: £2.1 billion revenue, £1.2 billion gross profit (61.6% gross margin)
* **2022**: £2.3 billion revenue, £1.4 billion gross profit (60.9% gross margin)
* **2023**: £926.9 million revenue in the first half, maintaining a gross margin around 61.0%​ (Ltd, 2024) (PLC, 2023)

Revenue and gross profit have consistently increased, showing excellent sales performance and good cost control. The little shift in gross margin indicates that profitability remains consistent despite economic difficulties (screneer, 2023).

1. **Operating Profit and Profit Before Tax:**

* **2021**: £415 million operating profit, £406 million profit before tax
* **2022**: £405.8 million operating profit, £405.8 million profit before tax
* **2023**: £117 million operating profit in the first half, £111.9 million profit before tax (Ltd, 2024) (PLC, 2023) (screneer, 2023).​

The operating profit as well as the profit before tax in 2023 has lesser figures compared to the previous years because of the new strategic costs such as depots’ expansion and some digital endeavors. This suggests a shift in corporate strategy, possibly away from the short-term towards the longer-term, and possibly lower immediate profits.

1. **Liquidity and Financial Gearing:**

* The financial analysis of Howdens showed that the company has treasured reasonable levels of cash throughout the period under analysis the company has sustained superior, cash flows from operations. This is evident from the large amounts of cash assets that were envisioned in their balance sheets (PLC, 2023).
* Based on the debt to equity ratio, the company's financial gearing is still prudent. This cautious attitude to borrowing acts as a safeguard against economic downturns and helps reduce financial risk.​

1. **Strengths and Weaknesses:**

**Strengths:**

* **Revenue Growth:** The continuous increase in earnings indicates robust consumer demand and efficient business practices.
* **Gross Margin Stability:** Sustaining a gross margin of approximately 61% signifies efficient cost control and pricing tactics.
* **Expansion Initiatives:** The company has demonstrated its proactive commitment to acquiring market share and future-proofing its business model through strategic investments in additional depots and digital platforms (investopedia, 2024).

**Weaknesses:**

* **Declining Operating Profit Margin:** Howdens has ensured that it has kept adequate cash on its balance sheet through decent Cash flow from operations. This is evident by the large amounts of cash that most of them have on their balance sheets.
* **Increased Operating Costs:** The costs of expansion are reflected in the increase in marketing, distribution, and administrative expenses, which could put pressure on short-term profitability.

**Critical Analysis**

Howdens Joinery PLC has seen rapid expansion over the last three years, but increased operational expenses have resulted in a drop in profit margins. This highlights the normal problem that businesses confront when balancing growth with profitability. The company's investments in new depots and digital infrastructure are designed to increase market presence and efficiency. However, careful management is essential to ensure that these investments provide long-term profits.

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